Joint Session
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Fact-finding preliminary to the examination of the Economic and Financial Planning Document for the period 2008-2011

Testimony of the Governor of the Bank of Italy

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Rome, 16 July 2007

Against the background of a recovery in economic activity, the public finances have improved considerably. However, the structural deficit remains substantial; it does not ensure a rapid reduction in the debt burden enabling Italy to tackle the challenge of population ageing in good time.

The Economic and Financial Planning Document envisages a budget for 2008 that does not improve the deficit on a current legislation basis. The budget will nevertheless have to include expenditure-side measures in order to finance outlays deriving from commitments made by the Government or necessary to continue policies under way but not yet embodied in legislation.

The corrective measures required to achieve a balanced budget are put off to the three years 2009-11; in particular, about half of the reduction is planned for 2011, the last year of the current legislature. The present favourable phase of the economic cycle would have made it possible to accelerate the budget adjustment.

The ratio of taxes and social security contributions to GDP is near the highest levels recorded in recent decades. The commitment to curbing and gradually reducing the fiscal burden is reaffirmed. A plan for significant tax reductions would provide support for the policies designed to increase the potential growth rate of the economy.

The Planning Document indicates controlling the quality and quantity of public spending as a priority. Reducing the deficit and containing taxation require a sharp deceleration in the growth of primary current expenditure, which in 2007 is again high and above the original target.

The Government is adopting support measures for old people in economic need. Given the projected demographic situation in the decades ahead, only courageous choices that raise the average effective retirement age can make it possible to pay adequate pensions.

1. *The state of the public finances*

The public finances improved in 2006, reflecting the sharp rise in revenue

The public finances improved in 2006. Excluding cyclical effects and one-off measures, the Government estimates that the deficit fell from 4 per cent of GDP in 2005 to 2.7 per cent last year; the primary surplus rose to 1.9 per cent of GDP.

General government net borrowing increased slightly, from 4.2 to 4.4 per cent of GDP. This outcome depended on the extraordinary charges deriving from the cancellation of railway company debt towards the State and from a European Court of Justice ruling on VAT (which together cost nearly 2 percentage points of GDP).

The improvement in the accounts in 2006 came from the significant increase in revenue, which benefited from stronger economic growth, some one-off measures and temporary factors, and the success of the measures to extend and recover tax base contained in the budget for 2006 and the supplementary measures enacted last July. The ratio of tax and social security receipts to GDP rose from 40.6 to 42.3 per cent.

More than half of the €37.7 billion increase in tax revenue can be attributed to trends in the main tax bases. Another 30 per cent can be ascribed to discretionary measures enacted with the budget for 2006 and the additional measures enacted in July. A further 5 per cent of the increase was due to favourable events during the year, in particular large-scale redemptions of post office savings certificates, which increased receipts from the taxes on interest income, and the return to the usual due dates for the tax on insurance companies' mathematical reserves. The remainder of the increase, some €6 billion, reflected the reduction of tax evasion and avoidance both as a result of enforcement action and in connection with some structural changes in the Italian economy in recent year (such as the increasingly important role of mass retailing).

Despite the acceleration in economic growth, the ratio of primary current expenditure to GDP remained basically constant, near the highest levels of recent decades. The reduction in intermediate consumption was offset by the rapid increase in social benefits. The contraction of public investment spending continued.

The deficit was considerably smaller than had been forecast both in drafting the budget and in the course of the year. Both the official estimates and other forecasts underestimated the growth in revenue; for that matter, receipts exceeded expectations in other euro-area countries as well.

The general government borrowing requirement decreased by 1.6 percentage points, to 3.7 per cent of GDP. The ratio of debt to GDP rose for the second successive year, reaching 106.8 per cent.

For 2007, Italy's stability programme update of last December indicated a deficit of 2.8 per cent of GDP. In March the Combined Report on the Economy and Public

Finances estimated net borrowing at 2.3 per cent. The Planning Document now projects it at 2.1 per cent

Revenue has grown more than expected in 2007 too; the Planning Document estimates net borrowing on a current legislation basis at 2.1 per cent of GDP

By comparison with the Combined Report, the revenue projection is revised upwards by more than €2 billion for the year, taking account of the better-than-expected revenues of the first few months. Expenditure is revised downwards by nearly €1 billion, reflecting, among other things, the postponement to 2008 of the renewal of several public-sector labour contracts.

The revised estimates for revenue are consistent with the results to date. Excluding the amounts collected in January, which appertained largely to 2006, by the end of June central government tax revenue was 5.1 per cent higher than in the same period of 2006. The Planning Document estimates the annual increase in general government tax revenues at 4.6 per cent for 2007, compared with 3.9 per cent in the Combined Report.

The behaviour of the borrowing requirement in the first part of the year is fundamentally consistent with the new estimates of net borrowing for 2007. In the first five months of the year the general government borrowing requirement amounted to €48.7 billion, about €10 billion less than in the same period of 2006.

Part of the improvement in the accounts is earmarked to finance additional spending

More than half of the improvement in the accounts with respect to the projections in December has now been earmarked by the Government for additional expenditure. In fact, together with the Planning Document, the Government has passed a decree law and a mid-year budget revision that according to official estimates will entail additional outlays of 0.4 percentage points of GDP this year and 0.1 points in each of the next two.

A good part of the additional expenditure in 2007 represents an adjustment of resources to the necessities of policies already in place; about a fifth reflects new Government initiatives.

The increase in outlays connected with Decree Law 81 of 2 July 2007 are estimated at €5.6 billion for this year and €1.6 billion a year when fully phased in. The decree comprises a number of measures. Most of the provisions (worth €2.5 billion) involve central government departments and consist in supplementary appropriations or attenuations of spending constraints enacted in previous budgets. In particular, with an effect valued at €1.5 billion, the decree frees the funds that ministries were obliged to set aside in unavailable reserves under the Finance Law for 2007. It also appropriates funds to increase low pensions (€0.9 billion), for humanitarian aid (€0.3 billion), for current transfers to public enterprises (€0.3 billion), and for short-term substitution of school personnel (€0.2 billion). Finally, it allocates €0.5 billion and €0.7 billion for the modernization of the road and railway networks, respectively.

The deficit target for 2007 is set at 2.5 per cent of GDP

Taking these measures into account, the Planning Document sets the new deficit target for 2007 at 2.5 per cent of GDP (compared with 2.8 per cent in last year's Document, which was confirmed in the subsequent budget documents). Excluding one-off measures – among which the transfer to INPS of a part of workers' annual severance pay – the deficit is nearly 3 per cent.

The ratio of public debt to GDP is projected to fall from 106.8 to 105.1 per cent.

The fiscal burden rises further, by half a percentage point, to 42.8 per cent of GDP. Excluding the severance pay referred to above, the increase comes to 0.1 percentage points. Primary expenditure, excluding the two extraordinary charges for 2006 mentioned earlier, rises from 44 to 44.1 per cent of GDP, reflecting the sharp increase of 19.1 per cent expected in direct investment.

Primary current expenditure increases by 4.3 per cent; its ratio to GDP declines slightly (from 39.9 to 39.8 per cent). The growth in expenditure is equal to 4.7 per cent for social benefits, 4.5 per cent for intermediate consumption and 1 per cent for wages and salaries.

* * *

The favourable economic situation would have allowed more ambitious objectives

In the last two years Italian budget policy has operated to comply with Italy's EU commitments to bring the deficit back below 3 per cent of GDP by 2007 and improve the structural budget balance by at least 1.6 percentage points in the two years 2006-07. The groundwork has been laid for ending the excessive deficit procedure against our country.

However, the favourable phase of the economic cycle would have made it possible to accelerate the adjustment of the public finances by acting on primary current expenditure.

In November 2006, in section II of its Forecasting and Planning Report, the Government planned an increase of 2.4 per cent in primary current expenditure this year. The Planning Document raises that to 4.3 per cent, only slightly less than the projected expansion of nominal GDP but constituting an increase of 2.4 per cent in real terms.

If the rate of increase planned in November had been maintained, the incidence of primary current expenditure on GDP in the Document's macroeconomic planning framework would have decreased by 0.8 percentage points between 2006 and 2007, reducing the deficit to 1.8 per cent.

In the five years from 2001 to 2005, the ratio of primary current expenditure to GDP rose in unfavourable cyclical conditions by 2.7 percentage points, to 40 per cent. In 2006-07, in favourable cyclical conditions, it is to be reduced by just 0.2 points.

2. The plan for 2008-2011

2.1. The overall guidelines

The Planning Document makes sustaining economic growth a priority

The priority objective set by the Planning Document is sustaining economic growth, within the constraints set by the need not to jeopardize budgetary equilibrium.

Development policies are designed to raise the economy's potential growth rate, bringing it nearer to the average for the rest of Europe. The actions planned are designed to close the gap in infrastructure, improve the efficiency of government and reduce the tax burden on firms and households. A rationalization of the automatic stabilizers to strengthen the system of incentives is also planned.

A strategic role is assigned to measures to foster greater competition in the markets for goods and services and combine environmental protection with a reduction in external energy dependency.

There is a commitment to renovating the school and university system, in the light among other things of the relatively poor standing of Italian education in international rankings. The Planning Document states the Government's intention to tackle the serious problems of the justice system, emphasizing that the shortcomings in this area seriously affect economic activity and the welfare of citizens.

Continuing along the lines of last year's Planning Document, greater support is to be provided to persons in economic difficulty, in particular to low-income families with dependent children, by increasing welfare benefits and renewing housing programmes.

The Planning Document maintains the objective set in last year's Document and reaffirmed in the December stability programme update of balancing the budget and achieving a primary surplus of about 5 per cent of GDP in 2011.

From 2008 onwards the deficit targets of the Planning Document are the same as those set in the stability programme, although the latter was based on much less favourable economic projections. The improvement in the baseline projections reduces the corrections necessary by an average of 0.3 percentage points of GDP each year in the four years 2008-2011.

For 2008 and 2009 forecast GDP growth has been revised upwards by comparison with the December projections by 0.4 and 0.1 percentage points respectively and the estimates for 2006 and 2007 by 0.3 and 0.7 points.

A modest reduction of the deficit in 2008; a balanced budget in 2011.

The financial adjustment path traced in the Planning Document envisages only a small reduction in net borrowing in 2008. Subsequently the improvement in the budget balance is projected to average 0.7 percentage points of GDP per year.

The ratio of the public debt to GDP is projected to decline by an average of 2.5 percentage points a year from 2008 through 2011 (1.9 points in 2008, 3.3 points in 2011). In 2010, for the first time since 1991, the debt is expected to fall below 100 per cent of GDP. In the December stability programme this result was forecast for 2011.

The earlier achievement of this objective depends largely on the faster growth of nominal GDP now forecast for the three years 2007-09 (an average of nearly 1 percentage point more per year).

The downward trend in debt also benefits from the assumption that from 2007 onwards the borrowing requirement will be approximately equal to net borrowing. However, excluding the two extraordinary charges included in net borrowing, in 2006 the gap between the two aggregates was equal to 1.2 per cent of GDP.

The Planning Document estimates an increase of 0.3 percentage points in the ratio of interest payments to GDP in 2006 and 2007 after it had fallen constantly for a decade. For the subsequent years, according to the planning scenario, the ratio will hold stable at just below 5 per cent, reflecting the expected decline in the debt ratio on the one hand and the progressive rise in interest rates on the other.

2.2 Budgetary policy for 2008

According to the Planning Document, in 2008 the deficit will fall by 0.3 percentage points, to 2.2 per cent of GDP, and the primary surplus rise from 2.3 to 2.7 per cent.

Achieving this objective does not require corrective measures with respect to the projections based on the “current legislation” framework (supplemented by the additional spending provided for by the decree law presented together with the Planning Document).

Nevertheless, for purposes of greater transparency, the Planning Document observes that the deficit on a current legislation basis excludes some costs that do not derive from obligations under the law but that are very likely to arise.

The Planning Document cites three classes of expenditure in decreasing order of obligation: those connected with commitments made by the Government, those bound to established practices such as appropriations for future labour contracts and for the

National Road Agency and the State Railways, and lastly those in connection with new initiatives.

The Planning Document puts expenditures for commitments already made at €4.1 billion and gives rough estimates of the second and third classes of respectively €l7.2 billion (not counting the resources for the renewal of public employment contracts, still to be determined) and €10 billion.

Including the first two classes of outlays for a total of over €11 billion gives an estimate of the deficit projected on an "unchanged policies" basis. This is nearly 2.9 per cent of GDP, excluding the resources for the renewal of public employment contracts.

To finance policies already in place, savings of at least 0.7 per cent of GDP will be needed

This second method of projection thus highlights the need for corrective measures equal to at least 0.7 per cent of GDP, to which must be added the resources for any new initiatives the Government decides to undertake.

The Document stresses that the containment and gradual reduction of the tax burden is a priority commitment. Consequently, additional outlays must be financed by expenditure savings. The Document does not specify how these will be achieved.

The Government hopes that the figures indicated for primary expenditure will be a point of reference in the discussion on the planning documents. It expressly requests Parliament, in its resolution on the Planning Document, to give an indication of its own on the level of primary expenditure that should serve as a guideline for the Government in drafting the Finance Bill and for Parliament in the discussion of the budget.

According to the projections on a current legislation basis, after growing sharply in 2006 and 2007 revenue will decline slightly in proportion to GDP, mainly as the result of the phasing in of the reduction in the tax wedge on labour enacted with the Finance Law for 2007.

3. Some evaluations

The Planning Document is more informative and transparent than in the past

Progress has been made in the Planning Document in terms of the quantity and transparency of the information provided. Specifically, estimates are given for expenditures that are very likely to be made but that are not included in the projections based on "current legislation". These data are essential to the proper evaluation of the present condition of the public finances and the outlook.

Hopefully in the future it will be possible to go beyond the indicative estimation of these costs with an explicit and detailed projection of the accounts on an unchanged-policies basis for the entire planning period. In addition, specifying the planning targets for revenue and expenditure as well as the nature of the corrective measures would permit better evaluation of the economic policy guidelines underlying the Planning Document.

The part of the Planning Document dedicated to economic development policies examines all the country's main problems. Its stress on the need for intervention in respect of justice and education, including the university system, is endorsable. Italy would benefit greatly from a more efficient civil justice system and a school and university system up to the standards of the other developed countries.

The medium-term objective is confirmed, but the bulk of the adjustment is postponed to 2011

The plans confirm the objective of a balanced budget in the medium term but do not exploit the improvement in the projections to hasten its attainment.

For 2008 the Document does not envisage a correction with respect to the balance projected on a current legislation basis. Last December's stability programme update planned a correction of 0.7 percentage points of GDP to achieve the same objective (a deficit of 2.2 per cent).

About half the corrective measures needed to balance the budget are put off to the last year of the planning horizon.

Additional initiatives reducing revenue or increasing expenditure (such as revising the law stiffening pension eligibility requirements as of 2008) would increase the size of the measures envisaged for the three years from 2009 through 2011, which the Planning Document now puts at 1.4 percentage points of GDP. In those years too, corrective measures will also have to offset spending commitments not included in the current legislation estimates, such as future labour contract renewals.

The experience of the first few years of this decade suggests that the favourable phases of the economic cycle should be exploited for a resolute reduction of the deficit. The risk is having to correct today's choices in the future, in possibly more difficult cyclical conditions.

In the autumn of 2000, after two years in which the public finances had performed better than predicted, the budget for 2001 provided for an increase in the deficit, the first after a number of years. The impact of the measures, for the most part tax reliefs, was estimated at more than 1 percentage point of GDP. The net borrowing target for 2001 was put at 0.8 per cent of GDP; a balanced budget was expected in 2003.

As early as mid-2001 the macroeconomic and financial outlook proved to be less favourable, necessitating corrective measures. The budget for 2002 had once again to curb the deficit, with an impact slightly less pronounced and of opposite sign to that of the year before. Finally, in the summer of 2002 further significant adjustment became necessary. The data available today indicate that the deficit amounted to about 3 per cent of GDP in both 2001 and 2002.

In the past years budget outturns worse than forecast have entailed repeated slippage of the timetable for adjusting the public finances. The year for budget balance, originally scheduled for 2003 in the Economic and Financial Planning Document released in 1999, has been repeatedly postponed, by nearly a decade now.

Rapid reduction of the public debt is essential

The achievement of structural budget balance is essential for rapid progress in reducing the public debt. Thanks in part to the consequent decrease in interest payments, debt reduction will make it possible to deal with the problems due to population ageing, increase the amount of resources allocated to productive expenditure and reduce the tax burden, and make room for manoeuvre during cyclical downturns.

Belgium has reduced its public debt from 122 per cent of GDP in 1997 to 89 per cent in 2006, with very considerable savings in interest payments. Major factors in the consolidation of the public finances were the introduction of rules making regional and local governments accountable and the institution of an independent authority (including representatives of central and regional governments and the central bank) that sets budgetary targets for all levels of government and reports any overshoots in the course of the year. Finally, by law any extra revenue with respect to forecasts must go entirely to reducing the debt.

Other European countries, some with significantly lower public debt than Italy's, have kept their budgets near balance or in surplus since the establishment of Monetary Union, among other things so as to be in a position to face the problems deriving from the ageing of the population.

Controlling the trend of expenditure is crucial

The Planning Document reaffirms the importance of controlling the quality and quantity of public spending in order to reconcile the adjustment of the public finances with a lowering of the fiscal burden, which is now near the highest levels registered in recent decades.

According to the Planning Document's macroeconomic framework, achieving a balanced budget in 2011 without increasing taxes or decreasing investment with respect to the budget on a current legislation basis requires that the ratio of primary expenditure to GDP fall by nearly 3 percentage points between 2008 and 2011, with an average annual reduction of outlays equal to 0.5 per cent in real terms, in contrast with an average annual increase of 2.3 per cent over the past decade.

According to the data provided by the Planning Document, on the basis of current legislation the ratio of primary expenditure to GDP is expected to decline by 0.2 percentage points in 2008. Based on unchanged policies, it would rise by several tenths of a point.

Other European countries have managed to reduce their budget deficits in recent years acting on the level and composition of spending. In Germany, for instance, the ratio of primary expenditure to GDP decreased from 45.5 per cent in 2003 to 42.9 per cent in 2006, lower than in Italy. This made it possible to reduce both the deficit, from 4 to 1.7 per cent of GDP, and tax revenue. Assuming unchanged policies, budget balance will be achieved in 2008. The reduction in expenditure has been concentrated in the areas of social benefits, labour incomes and, to a lesser extent, capital grants. It has not involved forgoing the fundamental goals of the welfare state.

In the field of pensions, in 2005 Germany introduced a rule limiting the revaluation of pension benefits in periods of a rising ratio of pension beneficiaries to contributors. There is also provision for the gradual raising of the standard retirement age from the current 65 to 67 by 2029.

A number of measures have also affected unemployment benefits and active labour market policies, with the aim of rationalizing the assignment of benefits and strengthening the incentives for the unemployed to accept job offers. The financing of the health system has been reformed to redistribute the costs between the public sector and patients, so as to make users more responsible. Public employment costs have been curbed by reducing the number of persons employed by an average of 1.5 per cent per year, and by even more pronounced wage moderation than in the private sector. The proposal for reform of the federal state is designed to increase the degree of financial autonomy of the various levels of government.

The debate in Parliament must focus on the level of spending

The Planning Document's proposal that the related parliamentary resolution indicate a ceiling for primary expenditure is a step in the right direction. This limit should be lower than or at most equal to the level set in the projection on a current legislation basis, and separate caps should be set for current and capital expenditure.

In the future these caps should not apply to spending by local authorities, in whose regard the Government last year redrafted the rules of the domestic stability pact, making the crucial criterion not a spending limit but a constraint on the final budget balance, so as to combine spending autonomy with fiscal accountability. It would be consistent with this approach for local authorities themselves to adopt rules on expenditure. Compliance with budget constraints must be based on an appropriate system of incentives and penalties.

The limits set at central level should also cover transfers to local government. Special attention must be devoted to the healthcare system, which is the principal component of local government expenditure and has recorded a sharp increase in recent years. Between 1998 and 2006 the ratio of health spending to GDP rose by about 1.5 percentage points, accounting for about 60 per cent of the entire increase in general government primary expenditure.

The recent enabling bill for the implementation of Article 119 of the Constitution lays the basis for the gradual abandonment of past spending as the standard for assigning resources to local entities in favour of standardized indicators of costs and requirements. This is the first step towards designing a system of incentives that by combining spending autonomy and financial accountability for local authorities can take full advantage of the efficiency made possible by decentralization. Hopefully the transition to the new legislative framework will be made within a reasonable time frame.

Spending caps must be accompanied by a redefinition of policies

International experience, which the Planning Document analyzes extensively, shows that in order to be effective spending caps must be based on a redefinition of the objectives of individual public programmes and on verification of efficient use of the resources allocated.

A contribution to more effective control of spending in the drafting of the Finance Bill and in the budget session of Parliament can come from the recently begun revision of the classification of the State budget items and analysis and evaluation of the expenditure of some ministries.

Making accounting documents and information more readable permits better measurement of the costs of public programmes and assessment of how well the distribution of resources corresponds to the purposes of public action. In the future, this could enhance the efficiency of public spending, overcoming the great budget rigidity produced by use of past spending as the main yardstick.

Lasting consolidation of the public finances depends on pensions policy

Choices in the field of pensions are crucial to the lasting consolidation of the public finances in a context in which, by Istat's estimates, the ratio of the population over 60 to the population of working age will rise from 42 per cent in 2005 to 53 per cent in 2020 and 83 per cent in 2040.

The State Accounting Office estimates that expenditure reflecting the ageing of the population will remain substantially constant in proportion to GDP until 2020 and rise thereafter. The increase between 2005 and 2040 will amount to 2.9 percentage points. Increased outlays on pensions (1.7 points) and on long-term care (1.8 points) will be partly offset by savings on education.

It is likely that in the absence of intervention these spending items will rise more sharply and sooner. The forecasts for healthcare spending consider only the effects of the changing age structure of the population. They do not take account of other factors such as the rising cost of medical treatment, which has increased health spending significantly in recent decades throughout the industrial world. As for long-term care, the changes in family structure and the increase in female employment could prompt greater demand for public assistance. The estimates of pension spending take account of the effects of current legislation, which includes the revision each decade of the coefficients for converting the contribution base into the annual pension entitlement and the tightening as of 2008 of the minimum pension eligibility requirements by Law 243/2004.

According to the State Accounting Office, with no updating of the conversion coefficients (which apply to benefits paid under the defined-contributions scheme introduced in 1995) the ratio of expenditure to GDP would be higher by 0.7 percentage points in 2030, 1.5 points in 2040 and about 2 points in 2050; other conditions being *equal, the ratio of the debt to GDP would be some 40 points higher. The measures introduced in 2004 raising the requirements for seniority pensions (which concern workers under the defined-benefit scheme) will reach a maximum restrictive effect on spending equal to 0.7 percentage points of GDP in 2012. This effect will remain broadly stable in the subsequent two decades; it will turn negative in the period 2040-50, when larger pensions will begin to be paid as a consequence of workers having contributed for more years. All else being equal, if the requirements are not tightened the ratio of the debt to GDP in 2050 would be about 20 percentage points higher.*

The increase in the lowest pensions that the Government has just decided aims at alleviating the situation of economic hardship in which a large number of elderly people live. The payment of adequate pension benefits to a growing number of old people is the challenge that needs to be faced in the coming years. The answers, in Italy as in all the advanced countries, are basically two: gradually raising the age at which people actually retire and developing supplementary pension provision.

An incentive to postpone retirement, in line with the lengthening of life expectancy, will derive from full application of the defined-contributions scheme introduced in 1995. Strengthening the link between contributions and benefits improves the system of incentives, reduces the disparities between different categories of workers and permits flexibility in deciding retirement age. The other countries that face demographic problems similar to ours are also moving in this direction.

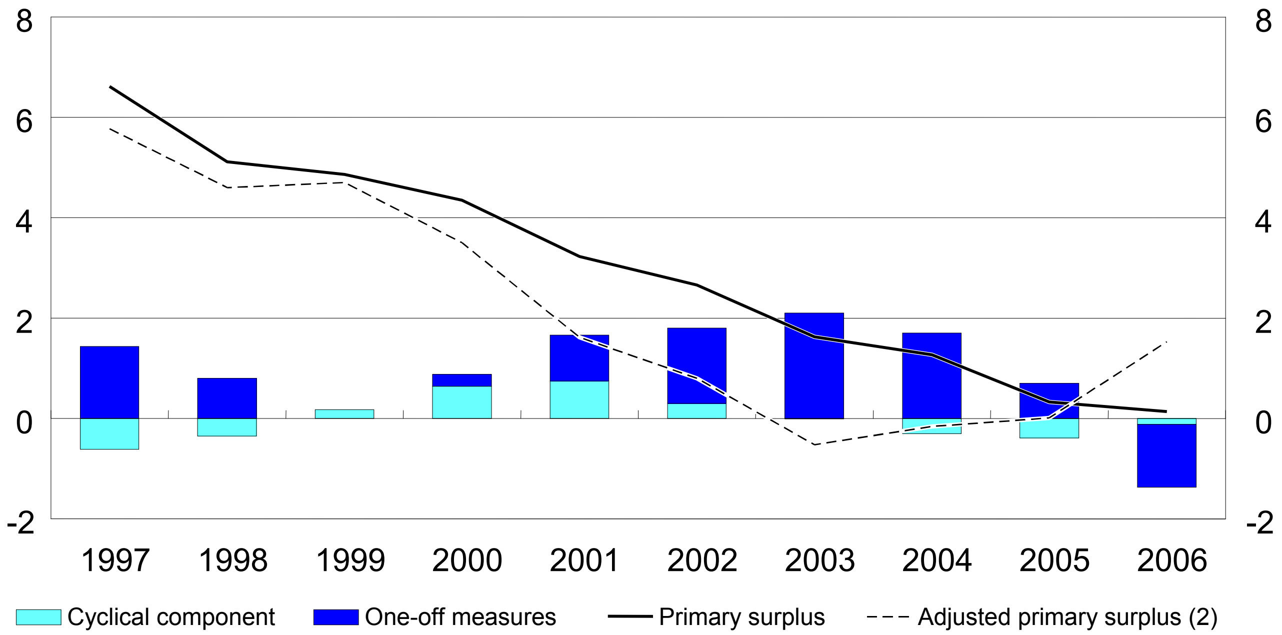
The updating of the conversion coefficients makes it possible to take the lengthening of life expectancy into account, although with considerable delay, and this is essential for long-term equilibrium between the outlays and receipts of the pension system. When expected longevity increases, modification of the coefficients lowers the income replacement rate, maintaining pension wealth unchanged; workers are entitled to a smaller monthly benefit, but receive it for a greater number of years. If the retirement age is flexible, this creates an incentive to prolong one's working career.

As is stressed in the Document, it is necessary to lengthen the time horizon of public action. Reducing the public debt and, I add, ensuring the sustainability of the pension system must constitute the State's first investment in favour of the country's young people and future generations.

Figures and Tables

Figure 1

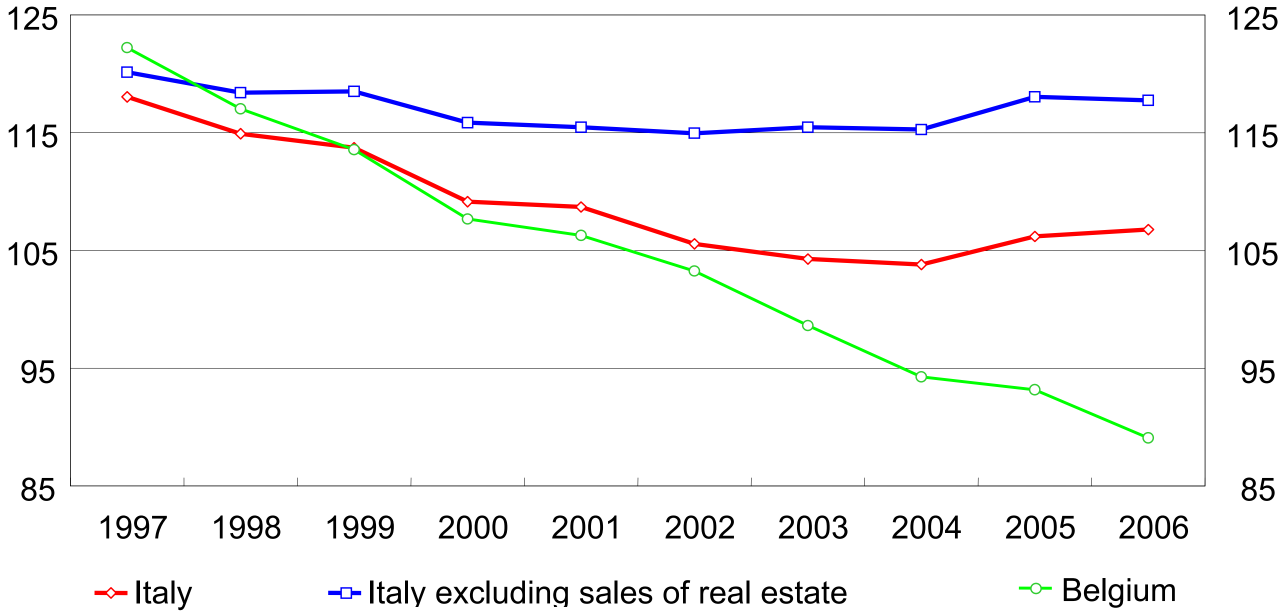
Primary surplus and temporary effects (1)
(as a percentage of GDP)



Sources: Based on Istat data.
(1) The estimates of temporary effects are based on the methods used by the Bank of Italy (see the Annual Report for 2006). (2) Adjusted for the effects of the economic cycle and one-off measures, as a percentage of trend GDP.

Figure 2

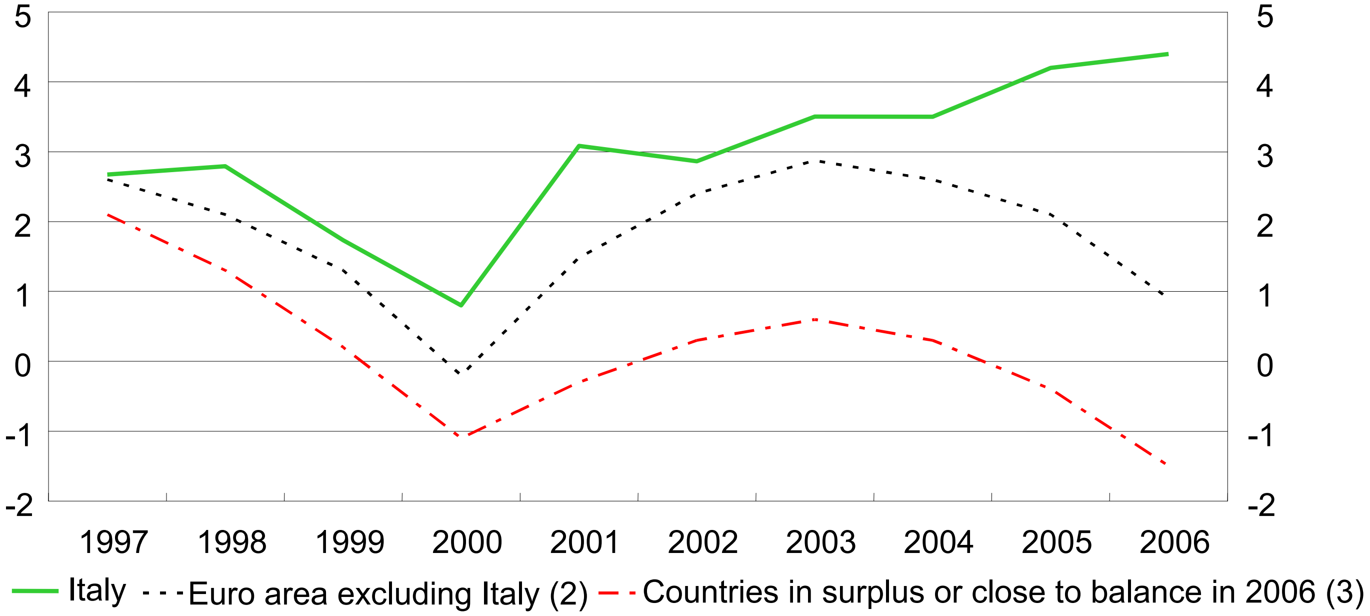
General government debt in Italy and Belgium (1)
(as a percentage of GDPL)



Sources: For Belgium, the European Commission.
(1) For Italy general government debt is also shown excluding the effects of asset sales (change in the Treasury's deposits with the Bank of Italy, sales of real estate and privatizations) and debt restructuring operations.

Figure 3

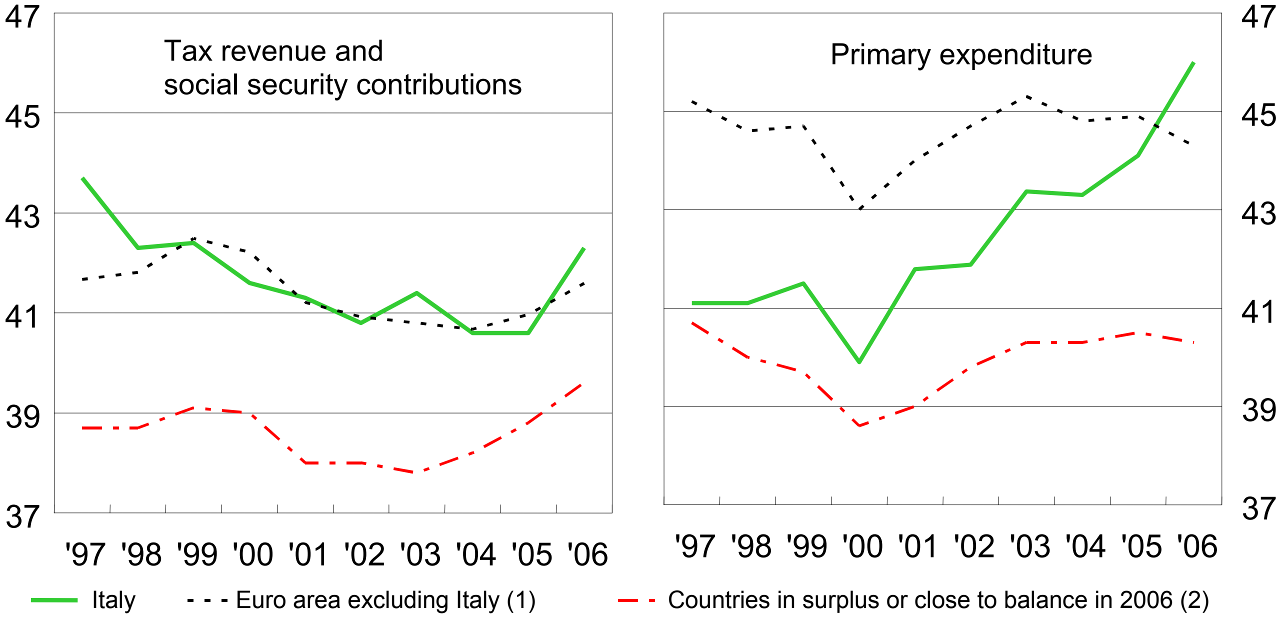
Net borrowing in Italy and the euro area (1)
(as a percentage of GDP)



Sources: Based on Istat and European Commission data.
(1) The figures include the effects of swaps and forward rate agreements. (2) For the sake of comparison, the euro area includes Greece for the entire period considered. (3) Belgium, Finland, Ireland, the Netherlands and Spain.

Figure 4

Tax revenue and social security contributions and primary expenditure in Italy and the euro area
(as a percentage of GDP)



Sources: Based on Istat and European Commission data.
(1) For the sake of comparison, the euro area includes Greece for the entire period considered.
(2) Belgium, Finland, Ireland, the Netherlands and Spain.

Figure 5

Average cost of the debt, average gross interest rate on BOTs and gross yield of 10-year BTPs
(percentages)

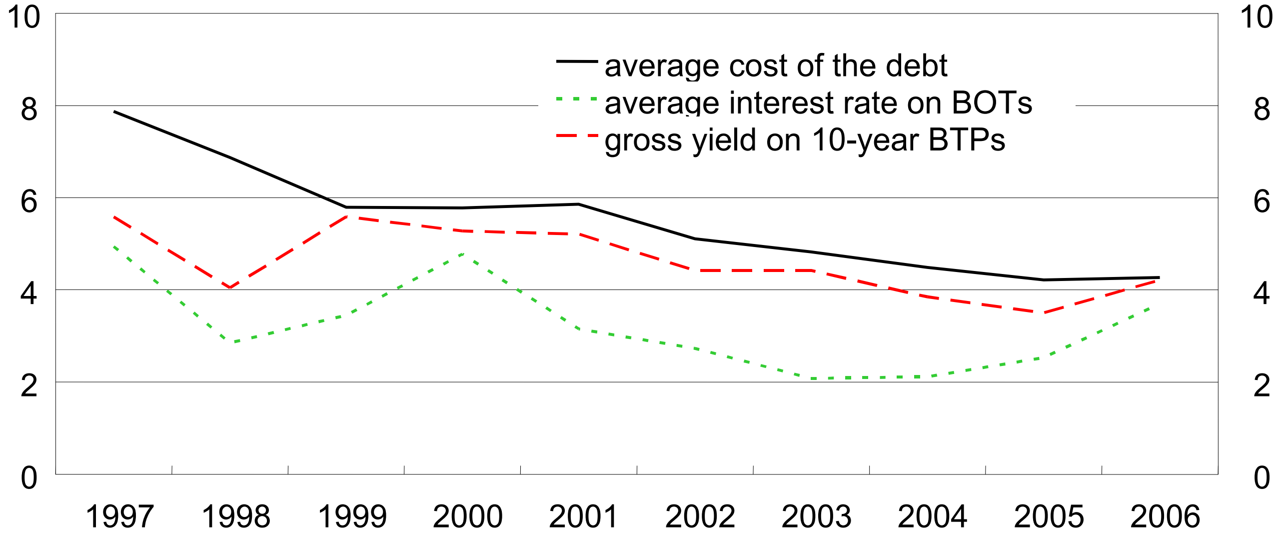


Figure 6

10-year yield differentials with respect to Italy
(basis points)

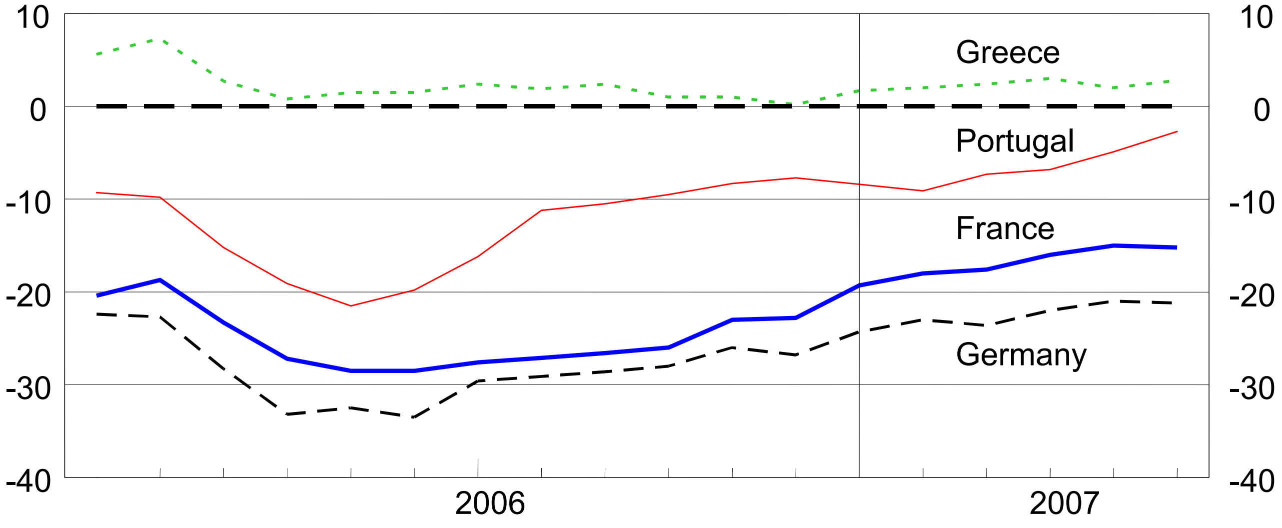
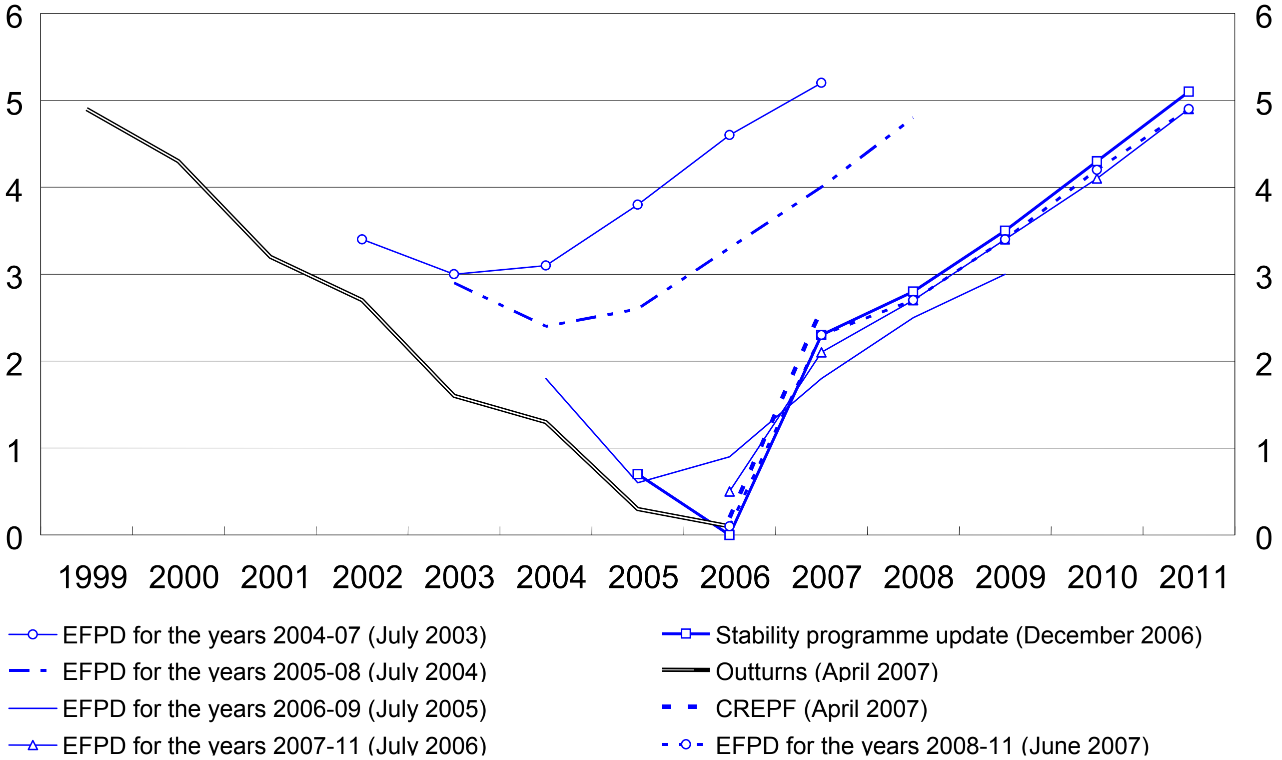


Figure 7

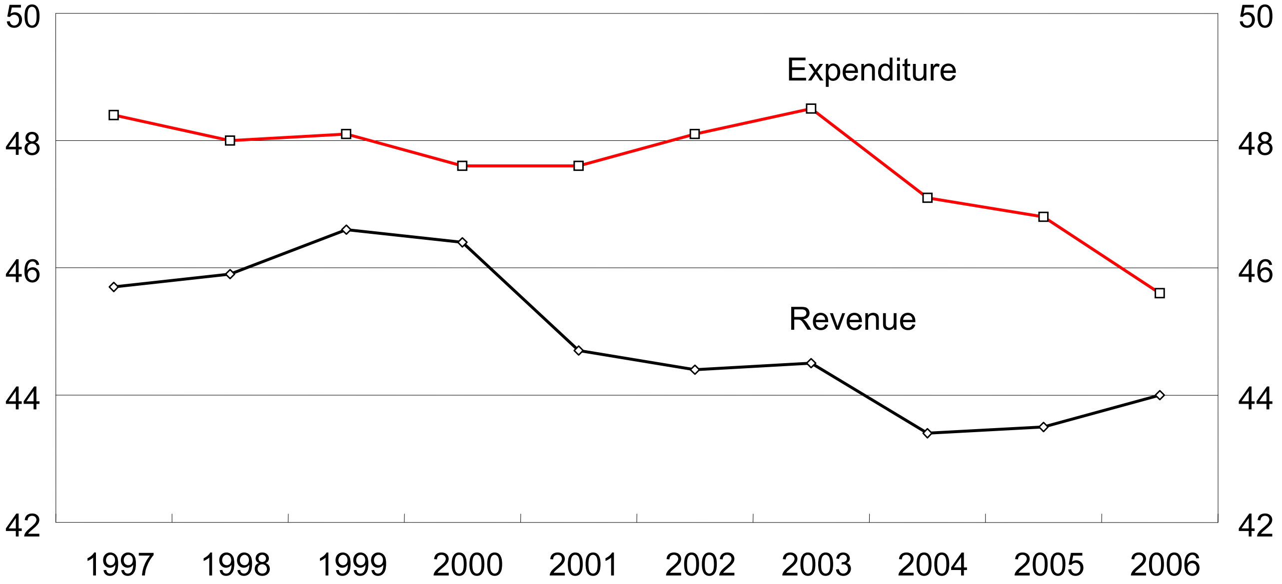
Primary surplus: objectives and outturns
(as a percentage of GDP)



Legend:
EFPD – Economic and Financial Planning Document
CREPF - Combined Report on the Economy and Public Finances

Figure 8

Revenue and expenditure in Germany
(as a percentage of GDP)



Source: European Commission,

Table 1

Main public finance indicators for general government (1)
(as a percentage of GDP)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Revenue	47.7	46.2	46.4	45.4	45.0	44.5	45.1	44.5	44.4	46.1
Expenditure (2) (3)	50.3	49.0	48.1	47.4	48.1	47.4	48.6	48.0	48.6	50.5
of which: *interest payments*	*9.3*	*7.9*	*6.6*	*6.3*	*6.3*	*5.5*	*5.1*	*4.7*	*4.5*	*4.6*
Primary surplus	6.6	5.1	4.9	4.3	3.2	2.7	1.6	1.3	0.3	0.1
Net borrowing	2.7	2.8	1.7	2.0	3.1	2.9	3.5	3.5	4.2	4.4
Borrowing requirement	1.8	2.6	1.4	2.2	4.6	2.9	3.0	3.6	4.9	3.7
Borrowing requirement net of privatization receipts	2.9	3.3	3.4	3.5	4.9	3.1	4.3	4.2	5.3	3.7
Debt	118.1	114.9	113.7	109.1	108.7	105.6	104.3	103.8	106.2	106.8

Source: Istat. For the borrowing requirememt and debt, Bank of Italy.
(1) Rounding may cause discrepancies in totals. (2) This item includes the proceeds of sales of public real estate with a negative sign (3) The figure for 2000 does not include the proceeds of the sale of UMTS licences, which are deducted from expenditure in the national accounts.

Table 2

General government revenue (1)
(as a percentage of GDP)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Direct taxes	15.8	14.3	14.9	14.4	14.7	13.9	13.4	13.3	13.4	14.5
Indirect taxes	12.2	15.1	14.9	14.7	14.2	14.3	14.0	14.1	14.2	14.8
Current tax revenue	**28.0**	**29.3**	**29.8**	**29.1**	**28.9**	**28.2**	**27.4**	**27.4**	**27.6**	**29.3**
Actual social contributions	14.6	12.2	12.2	12.1	12.0	12.2	12.4	12.4	12.6	12.8
Imputed social contributions	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2
Current tax revenue and social security contributions	**43.0**	**42.0**	**42.3**	**41.5**	**41.2**	**40.6**	**40.0**	**40.0**	**40.5**	**42.3**
Capital taxes	0.7	0.4	0.1	0.1	0.1	0.2	1.3	0.6	0.1	0.0
Total tax revenue and social security contributions	**43.7**	**42.3**	**42.4**	**41.6**	**41.3**	**40.8**	**41.4**	**40.6**	**40.6**	**42.3**
Other current revenue	3.7	3.6	3.6	3.4	3.5	3.5	3.4	3.6	3.5	3.5
Other capital revenue	0.3	0.3	0.4	0.3	0.2	0.2	0.3	0.3	0.3	0.3
Total revenue	**47.7**	**46.2**	**46.4**	**45.4**	**45.0**	**44.5**	**45.1**	**44.5**	**44.4**	**46.1**

Source: Based on Istat data.
(1) Rounding may cause discrepancies in totals.

Table 3

General government expenditure (1)
(as a percentage of GDP)

	1998	1999	2000	2001	2002	2003	2004	2005	2006
Compensation of employees excluding the health sector	8.7	8.6	8.4	8.5	8.5	8.8	8.6	8.8	8.8
Intermediate consumption excluding the health sector	3.9	4.0	4.0	4.1	4.1	4.2	4.2	4.2	3.9
Health expenditure	4.9	5.0	5.3	5.6	5.7	5.7	6.1	6.3	6.4
Social benefits in cash	16.7	16.9	16.4	16.2	16.5	16.8	16.9	17.0	17.1
Other current expenditure	3.2	3.2	3.1	3.3	3.4	3.6	3.6	3.6	3.7
Primary current expenditure	**37.3**	**37.6**	**37.3**	**37.6**	**38.3**	**39.1**	**39.3**	**40.0**	**39.9**
Interest payments	7.9	6.6	6.3	6.3	5.5	5.1	4.7	4.5	4.6
Total current expenditure	**45.2**	**44.2**	**43.6**	**43.9**	**43.8**	**44.2**	**44.1**	**44.5**	**44.5**
Investment net of real-estate sales	2.3	2.4	2.4	2.5	2.6	2.7	2.7	2.6	2.4
Real-estate sales			-0.1	-0.2	-0.8	-0.2	-0.3	-0.2	-0.1
Other capital expenditure (2)	1.4	1.5	1.4	1.8	1.9	1.9	1.5	1.7	3.7
Total capital expenditure (2)	**3.8**	**3.9**	**3.7**	**4.2**	**3.6**	**4.3**	**3.9**	**4.1**	**6.0**
Capital expenditure net of real-estate sales (2)	*3.8*	*3.9*	*3.8*	*4.3*	*4.5*	*4.5*	*4.2*	*4.3*	*6.1*
Total expenditure (2)	**49.0**	**48.1**	**47.4**	**48.1**	**47.4**	**48.6**	**48.0**	**48.6**	**50.5**
of which: *excluding interest payments* (2)	*41.1*	*41.5*	*41.0*	*41.8*	*41.9*	*43.4*	*43.3*	*44.1*	*46.0*

Source: Based on Istat data.
(1) Rounding may cause discrepancies in totals. (2) The figure for 2000 does not include the proceeds of the sale of UMTS licences (1,2 per cent of GDP in 2000). In the national accounts these receipts are entered as a deduction from the item "Other capital expenditure".

Table 4

General government borrowing requirement
(millions of euros)

	Year			First 5 months		
	2004	2005	2006	2005	2006	2007 (1)
Borrowing requirement net of settlements of past debts and privatization receipts	**57,462**	**73,047**	**54,331**	**59,666**	**58,742**	**48,581**
Settlements of past debt	529	1,864	243	125	71	105
- in securities	*2*	*11*	*2*	*11*	*2*	*0*
- in cash	*527*	*1,853*	*241*	*114*	*69*	*105*
Privatization receipts	-8,316	-4,618	-38	-4	0	-3,500
Borrowing requirement	**49,675**	**70,294**	**54,536**	**59,787**	**58,812**	**45,186**
FINANCING						
Cash and deposits (2)	16,364	21,574	7,601	7,911	10,840	-8,619
- of which: Post Office deposits	*-1,187*	*-4,177*	*-4,957*	*-2,153*	*-1,318*	*-9,466*
Short-term securities	-998	-924	4,867	20,273	25,094	23,023
Medium and long-term securities	41,609	39,989	33,151	45,818	22,610	30,793
Loans from MFIs	-1,409	5,593	63,594	2,694	1,748	2,815
Other liabilities (3)	-5,890	4,061	-54,677	-16,910	-1,479	-2,826
- of which: deposits with the Bank of Italy	*-2,578*	*1,197*	*-8,230*	*-19,693*	*-7,799*	*-3,269*
Memorandum item: borrowing requirement financed abroad	4,904	4,007	-7,109	3,811	-906	8

(1) Provisional. (2) Post Office funds, notes and coins in circulation, and deposits held with the Treasury by entities not included in general government. (3) Deposits held with the Bank of Italy, securitization receipts and Cassa Depositi e Prestiti S.p.A loans to general government.

Table 5

Current legislation forecasts and Government targets in the Economic and Financial Planning Document (EFPD) for 2008-11 and 2007-11

(as a percentage of GDP)

	2006	2007		2008		2009		2010		2011	
	Outturn	EFPD 2007-2011	EFPD 2008-2011	EFPD 2007-2011	EFPD 2008-2011	EFPD 2007-2011	EFPD 2008-2011	EFPD 2007-2011	EFPD 2008-2011	EFPD 2007-2011	EFPD 2008-2011
	CURRENT LEGISLATION FORECASTS										
Net borrowing	4.4	4.1	2.1	4.1	2.1	4.1	1.8	3.9	1.3	3.8	1.1
of which: current	*-1.3*	*0.2*	*-1.8*	*0.3*	*-1.6*	*0.2*	*-2.0*	*0.2*	*-2.3*	*0.2*	*-2.4*
: capital	*5.7*	*3.9*	*3.9*	*3.8*	*3.7*	*3.9*	*3.8*	*3.7*	*3.6*	*3.6*	*3.5*
Primary surplus	0.1	0.8	2.7	0.8	2.7	1.1	3.1	1.3	3.5	1.5	3.7
Total revenue	46.1	44.8	46.4	44.6	46.2	44.6	46.1	44.5	45.8	44.4	45.6
of which: taxes and social security contributions	*42.3*	*41.0*	*42.8*	*40.9*	*42.6*	*40.9*	*42.5*	*40.8*	*42.3*	*40.7*	*42.1*
Primary expenditure	46.0	44.0	43.7	43.8	43.5	43.6	42.9	43.2	42.3	42.9	41.9
of which: current	*39.9*	*39.8*	*39.5*	*39.7*	*39.5*	*39.3*	*38.9*	*39.2*	*38.4*	*38.9*	*38.1*
: capital	*6.0*	*4.2*	*4.2*	*4.1*	*4.0*	*4.3*	*4.1*	*4.1*	*3.9*	*3.9*	*3.8*
Interest payments	4.6	4.8	4.8	5.0	4.9	5.1	4.9	5.2	4.9	5.3	4.9
	CURRENT LEGISLATION FORECASTS ADJUSTED FOR THE EFFECTS OF DECREE LAW 81/207										
Net borrowing	4.4	4.1	2.5	4.1	2.2	4.1	1.9	3.9	1.4	3.8	1.3
of which: current	*-1.3*	*0.2*	*-1.5*	*0.3*	*-1.5*	*0.2*	*-1.9*	*0.2*	*-2.2*	*0.2*	*-2.3*
: capital	*5.7*	*3.9*	*4.0*	*3.8*	*3.7*	*3.9*	*3.8*	*3.7*	*3.6*	*3.6*	*3.6*
Primary surplus	0.1	0.8	2.3	0.8	2.6	1.1	3.0	1.3	3.4	1.5	3.6
Total revenue	46.1	44.8	46.4	44.6	46.3	44.6	46.1	44.5	45.8	44.4	45.6
of which: taxes and social security contributions	*42.3*	*41.0*	*42.8*	*40.9*	*42.6*	*40.9*	*42.5*	*40.8*	*42.3*	*40.7*	*42.1*
Primary expenditure	46.0	44.0	44.1	43.8	43.6	43.6	43.0	43.2	42.4	42.9	42.0
of which: current	*39.9*	*39.8*	*39.8*	*39.7*	*39.6*	*39.3*	*39.0*	*39.2*	*38.5*	*38.9*	*38.2*
: capital	*6.0*	*4.2*	*4.3*	*4.1*	*4.0*	*4.3*	*4.1*	*4.1*	*3.9*	*3.9*	*3.8*
Interest payments	4.6	4.8	4.8	5.0	4.9	5.1	4.9	5.2	4.9	5.3	4.9
	GOVERNMENT TARGETS										
Net borrowing	4.4	2.8	2.5	2.2	2.2	1.6	1.5	0.8	0.7	0.1	-0.1
Primary surplus	0.1	2.1	2.3	2.7	2.7	3.4	3.4	4.1	4.2	4.9	4.9
Interest payments	4.6	4.8	4.8	4.9	4.9	5.0	4.9	5.0	4.9	5.0	4.8
Debt	106.8	107.5	105.1	107.0	103.2	105.1	101.2	102.6	98.3	99.7	95.0